No. 15-145

In the Supreme Court of the United States

HUSKY INTERNATIONAL ELECTRONICS, INC.,

Petitioner,

v

DANIEL LEE RITZ, JR.,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF BANKRUPTCY LAW PROFESSORS AS *AMICI CURIAE* IN SUPPORT OF PETITIONER

JOHN J. MONAGHAN
KATHLEEN ST. JOHN
HOLLAND & KNIGHT LLP
10 Saint James Ave.
Boston, MA 02116

JERROLD J. GANZFRIED
Counsel of Record
HOLLAND & KNIGHT LLP
800 17th Street, N.W.
Washington, D.C. 20006
(202) 469-5151
jerry.ganzfried@hklaw.com

ROBERT J. LABATE
RICHARD A. BIXTER, JR.
HOLLAND & KNIGHT LLP
131 South Dearborn St.
Chicago, IL 60603

BARBRA PARLIN
HOLLAND & KNIGHT LLP
31 West 52nd STREET
New York, NY 10019

Counsel for Amici Curiae

TABLE OF CONTENTS

INTEREST OF *AMICI CURIAE*.....1

SUMMARY OF ARGUMENT.....3

ARGUMENT 5

Section 523(a)(2)(A) Precludes A Discharge In Bankruptcy For Any Debt Obtained By A Debtor's Actual Fraud

1. The Bankruptcy Code, its antecedents and legislative history make clear that "actual fraud" means intentional wrong, and is not dependent on a debtor making a misrepresentation to a creditor. 7

2. The rule set forth in *Neal v. Clark*, distinguishing between intentional fraud and constructive fraud in dischargeability cases was carried forward in the Bankruptcy Act of 1898. ... 9

3. The Bankruptcy Code enacted in 1978 codified the *Neal v. Clark* distinction. 12

4. Contrary to the Fifth Circuit's view, the common law does not compel a narrow definition of "actual fraud." 17

5. Sound public policy supports the conclusion that § 523(A)(2)(A) does not limit "actual fraud" to false representations made by a debtor to a creditor. 24

CONCLUSION 30

TABLE OF AUTHORITIES

Page(s)

Cases

Archer v. Warner,
538 U.S. 314 (2003).....13, 15, 16, 24

In re Bernard L. Madoff Inv. Securities LLC,
424 B.R. 122, 127 (S.D.N.Y. 2010) 29

Brown v. Felsen,
442 U.S. 127 (1979).....11

Bullock v. BankChampaign, N.A.,
133 S.Ct. 1754 (2013).....16

Cohen v. de la Cruz,
523 U.S. 213 (1998).....*passim*

Davis v. Aetna Acceptance Co.,
293 U.S. 328 (1934).....10, 12

Eisenstein v. Eisenstein,
525 B.R. 428 (Bankr. N.D. Ill. 2015).....23

Field v. Mans,
526 U.S. 59 (1995).....17, 24

Forsythe v. Yeley,
508 B.R. 82 (S.D. Ind. 2014) 23

Grogan v. Garner,
498 U.S. 279 (1991).....11

Hennequin v. Clew,
111 U.S. 676 (1884).....9

Landmark Credit Union v. Reichartz (In re Reichartz),
529 B.R. 696 (Bankr. E.D. Wisc. 2015).....23

Loucks v. McCormick
424 P.2d 555 (Kan. 1967) 22

McAleer v. Horsley
35 Md. 439 (1872) 18

McClellan v. Cantrell,
217 F.3d 890 (7th Cir. 2000).....19, 23

Neal v. Clark,
95 U.S. 704 (1877).....*passim*

Noble v. Hammond,
129 U.S. 65 (1889).....7

Palmer v. Hussey,
119 U.S. 96 (1886).....9

Peterson v. Somers Dublin Ltd.,
729 F.3d 741, 744 (7th Cir. 2013).....28

Picard v. JPMorgan Chase & Co. (In re Bernard L. Madoff Securities LLC),
721 F.3d 54, 60 (2d Cir. 2013) 29

In re Rice & Reuben,
43 F.2d 378 (D. Me.1930) 10

Ritchie Capital Management, L.L.C. v. Jeffries,
653 F.3d 755, 757 (8th Cir. 2011).....28

Sauer v. Lawson, Inc.,
791 F.3d 214 (1st Cir. 2015) 18, 20

Stonemets v. Head
154 S.W. 108 (Mo. 1913).....18

Strang v. Bradner,
114 U.S. 555 (1885).....9

United States v. Fry
792 F.3d 884 (8th Cir. 2015).....29

United States v. Reynolds,
643 F.3d 1130, 1132 (8th Cir. 2011).....28

Wallave v. Wallace
291 S.E.2d 386 (W.Va. 1982).....20

Statutes

11 U.S.C. § 523(a)(2)(A) .....*passim*

11 U.S.C. § 523(a)(6) 25

11 U.S.C. § 727 26

18 U.S.C. § 152 26

Bankruptcy Act of 1867, 14 Stat. 5117 7

Bankruptcy Act of 1898, 30 Stat. 550 .....9, 14

Bankruptcy Act of 1898, 32 Stat. 798 9

Other Authorities

1978 U.S.C.C.A.N. 5963 (95th Cong., 2d Sess.) 13

H. Rpt. No. 1698 (1902) 9, 10

H. Rpt. No. 95-595 (1978) 13

Restatement (Second) of Torts § 537 (1977).....17

Restatement (Second) of Torts § 540 (1977).....17

Restatement (Second) of Torts § 871 (1977).....17, 18

S. Rpt. No. 95-989 (1978).....13

INTEREST OF *AMICI CURIAE*[1]

Amici curiae are professors who teach, study and write about bankruptcy law. Through their scholarship, *amici* have focused on the text, structure, history, and policy underpinnings of the Bankruptcy Code; the application of bankruptcy law by courts nationwide; and the practical economic impact of the bankruptcy system on the people and institutions of the United States. Accordingly, *amici* have a deep interest in the correct interpretation of the Bankruptcy Code and the correct implementation of the important public policies on which bankruptcy law is based.

Anthony Casey is Assistant Professor of Law and the Mark Claster Memolen Teaching Scholar at the University of Chicago Law School.

Ronald Mann is the Albert E. Cinelli Enterprise Professor of Law, and Co-Director of the Charles Evans Gerber Transactional Studies Center at Columbia Law School.

Edward R. Morrison is the Charles Evans Gerber Professor of Law at Columbia Law School.

Robert K. Rasmussen holds the J. Thomas McCarthy Trustee Chair in Law and Political Science

---

[1] Letters of consent have been filed with the Clerk. Pursuant to Supreme Court Rule 37.6, *amici curiae* state that no counsel for a party has authored this brief in whole or in part, and no person or entity, other than the *amici curiae* or their counsel, made a monetary contribution to the preparation or submission of this brief.

at the University of Southern California Gould School of Law.

Alan Schwartz is a Sterling Professor of Law at Yale Law School.

David A. Skeel is the S. Samuel Arsht Professor of Corporate Law at the University of Pennsylvania Law School.

Amici take no position on the underlying dispute between the parties: whether respondent is entitled to discharge a debt to the petitioner in the particular circumstances of this case. *Amici* submit this brief to address the Fifth Circuit's narrow reading of the statutory words "actual fraud" in Bankruptcy Code Section 523(a)(2)(A). Contrary to the holding of the Fifth Circuit, those statutory words are not limited only to circumstances in which a debtor made false representations to a creditor. Such a restrictive reading of § 523(a)(2)(A), would reward the dishonest — especially the more ingeniously dishonest — at the expense of the victims they intended to defraud. The Fifth Circuit's reading would, moreover, upset the Bankruptcy Code's balance between affording a fresh start to honest but unfortunate debtors and policing against fraudulent conduct by debtors.

SUMMARY OF ARGUMENT

The term "actual fraud" as a basis for denying the discharge of a debt in bankruptcy is not confined to a static definition that requires, in every instance, a false representation by the debtor to the creditor. Consistent with more than a century of judicial explanation, the inclusion of "actual fraud" in Bankruptcy Code § 523(a)(2)(A) as one of three bases for excepting a debt from the scope of a discharge afforded debtors in bankruptcy applies to more than just misrepresentations.

The narrow conception of "actual fraud" upon which the decision below is based is both historically inaccurate and inherently unsound. It is historically inaccurate because for almost 140 years this Court and Congress have employed a different standard. As early as *Neal v. Clark*, 95 U.S. 704 (1877), this Court equated "actual fraud" with intentional "positive fraud" and distinguished that conduct from "constructive fraud." Debt arising from the former has long been nondischargeable, while debt arising from the latter can be discharged. Neither category has ever been viewed as requiring a representation of any sort in the context of a dischargeability challenge. That distinction has remained a guiding principle of this Court's jurisprudence. Most important with respect to the correct disposition of this case, that distinction was expressly invoked as a guiding principle for the 1978 enactment of the Bankruptcy Code. Even outside the context of dischargeability challenges, the decision below is

also historically inaccurate because it misperceives the state of the common law in 1978, as well as the state of the common law today.

The Fifth Circuit's definition of "actual fraud" is inherently unsound because it would create a "how-to" manual for intentional wrongdoers to be rewarded for their deception. A potential wrongdoer can use the Code's discharge provisions as shelter — evading liability for intentional wrongdoing — simply by structuring the fraud to avoid making a false representation to a creditor. The Fifth Circuit's definition of "actual fraud," therefore, rewards dishonest conduct in a way not contemplated by the text or legislative history of the Bankruptcy Code. As some modern Ponzi schemes illustrate, technology enables the commission of fraud on a massive scale, in remote ways, using hard-to-detect devices. For these reasons, the Fifth Circuit's requirement of a false representation by the debtor to the creditor is bad economic and social policy. Bad economic policy because it hinders the victims of intentional wrongdoers from being made whole. Bad social policy because it rewards intentionally fraudulent behavior that attacks the integrity of the bankruptcy system. In short, the decision below would upset the Bankruptcy Code's careful balance between (a) providing a fresh start for honest-but-unfortunate debtors and (b) preventing the fresh start from "giving the perpetrators of fraud a fresh start over the interest in protecting the victims of fraud." *Cohen v.*

de la Cruz, 523 U.S. 213, 223 (1998) (*quoting Grogan v. Garner*, 498 U.S. 279, 287 (1991)).

ARGUMENT

SECTION 523(a)(2)(A) PRECLUDES A DISCHARGE IN BANKRUPTCY FOR ANY DEBT OBTAINED BY A DEBTOR'S ACTUAL FRAUD

Section 523(a)(2)(A) of the Bankruptcy Code excepts "any debt ... for money, property, services, or an extension, renewal or refinancing of credit, to the extent obtained by ... false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition." 11 U.S.C. § 523(a)(2)(A). If, as the Fifth Circuit held, "actual fraud" cannot be established where "the debtor made no false representation to the creditor" (Pet. App. 6a-7a), then the statutory category of "actual fraud" is wholly redundant. Since petitioner's merits brief explains the multiple ways in which the Fifth Circuit's holding runs counter to this Court's longstanding canons of statutory construction, *amici* will not replow that ground here.

A simple schematic illustration should suffice: Under the Fifth Circuit's view, a party opposing a discharge must prove **A** ***or*** **A+B.** If the party opposing discharge fails to prove **A**, then it necessarily loses under both category **A** and category **A+B.** And if the party opposing discharge

successfully proves **A**, then it has prevailed under category **A** and neither it nor the court has any reason to address category **A+B.** Accordingly, under the decision below, **B** drops out of the statute altogether and category **A+B** plays no role in any potential scenario. That is not how legislatures draft statutes. That is not how courts interpret statutes.

By asking whether "actual fraud" is entirely subsumed by the "false representation" category, the Fifth Circuit embarked on the wrong inquiry, which led it to the wrong result. As *amici* will explain, the correct inquiry should take the statute as written, and then focus on the separate meaning and substance of each category in § 523(a)(2)(A).

Rigorous analysis should also be informed by this Court's historic understanding that "[t]he Bankruptcy Code has long prohibited debtors from discharging liabilities incurred on account of their fraud, embodying a basic policy animating the Code of affording relief only to an honest but unfortunate debtor." *Cohen v. de la Cruz*, 523 U.S. 213, 217 (1998). Consistent with that stated policy, the fraud exception from discharge is not limited to fraud perpetrated through the use of a misrepresentation; rather, the statutory exception from discharge covers a broad array of deceitful conduct and intentional wrongs, specifically including fraudulent-transfer schemes intended to harm a creditor.

1. The Bankruptcy Code, its antecedents and legislative history make clear that "actual fraud" means intentional wrong, and is not dependent on a debtor making a misrepresentation to a creditor.

The Bankruptcy Code's exception for discharge of debts obtained by actual fraud originated in Section 33 of the Bankruptcy Act of 1867, which provided that "no debt created by the fraud or embezzlement of the bankrupt or by defalcation as a public officer, or while acting in a fiduciary capacity, shall be discharged under this act .." Bankruptcy Act of 1867, 14 Stat. 5117. Section 33 of the 1867 Bankruptcy Act was "substantially a re-enactment of the act of 1841" except for the addition of the phrase not appearing in the 1841 Act that "no debt created by fraud . ." was dischargeable. *Noble v. Hammond*, 129 U.S. 65, 69 (1889).

The 1867 Act did not expressly define the newly-added term "fraud." In *Neal v. Clark*, 95 U.S. 704 (1877), this Court first articulated the type of fraud that justified denial of discharge under Section 33 of the 1867 Act. As Justice Harlan's opinion for the Court explained, the controversy in *Neal* arose from a constructive fraudulent transfer, which the lower courts found to be sufficient to justify exclusion of the underlying debt from the bankruptcy discharge.

The central point — and the one most pertinent to defining "actual fraud" in the current statute —

was the distinction the Court drew in *Neal* between constructively fraudulent transfers (which were insufficient to exclude a debt from discharge under the 1867 Act), and intentionally fraudulent transfers (for which debt discharge would be denied):

> [D]ebts created by 'fraud' are associated directly with debts created by 'embezzlement.' Such association justifies, if it does not imperatively require, the conclusion that the 'fraud' referred to in that section means positive fraud, or fraud in fact, involving moral turpitude or intentional wrong, as does embezzlement; and not implied fraud, or fraud in law, which may exist without the imputation of bad faith or immorality.

Neal v. Clark, 95 U.S. 704 at 709.

The term "fraud" included "positive fraud" such as fraud in fact and was not limited to misrepresentation. And "actual fraud" sufficient to deny discharge under the 1867 Act was to be found in any conduct involving moral turpitude or intentional wrong.

This Court continued to apply the *Neal v. Clark* definition of fraud throughout the Nineteenth Century. Repeatedly, the Court distinguished acts of actual fraud, involving bad faith, moral turpitude, or wrongful intent, from conduct that was merely

constructively fraudulent. *See Strang v. Bradner*, 114 U.S. 555, 559 (1885); *Hennequin v. Clew*, 111 U.S. 676 (1884); *Palmer v. Hussey*, 119 U.S. 96 (1886).

2. The rule set forth in *Neal v. Clark*, distinguishing between intentional fraud and constructive fraud in dischargeability cases was carried forward in the Bankruptcy Act of 1898.

As initially enacted, the 1898 Act prohibited discharge of "judgments in actions for fraud, or obtaining property by false pretenses or false representations," § 17(a)(2), 30 Stat. 550. Five years later, Congress amended §17(a)(2) to eliminate the requirement that the debt be reduced to "judgment" and also deleted the word "fraud." § 17(a)(2), 32 Stat. 798. The House Report explained:

> [The amendment to Section 17(a)(2) of the Bankruptcy Act] provides that liabilities for frauds, etc., as described in the act shall not be released by the discharge. As the law now is these liabilities must have been reduced to judgment or else the bankruptcy is discharged. This amendment is in the interest of justice and honest dealing and honest conduct. H. Rpt. No. 1698, 57th Congress, 1st Sess., 3 (1902).

> The changes in section 17 of the law are to settle questions arising from the antagonistic decisions of the court and to exclude beyond peradventure certain liabilities growing out of offenses against good morals from the effect of a discharge. *Id.* at 6.
>
> . . .
>
> The substitution of "liabilities" for "judgments in actions" makes the clause broader. Now claims created by fraud but not reduced to judgment are discharged. Neither the claim nor the judgment should be. [citations omitted]. The reasons for the other changes are too patent to require statement. *Id.*

Accordingly, in cases arising under the 1898 Act this Court consistently applied the *Neal v. Clark* formulation of "fraud" requiring intentional conduct. In *Davis v. Aetna Acceptance Co.*, 293 U.S. 328, 333 (1934), for example, the Court acknowledged the continuing vitality of Justice Harlan's interpretation of such statutory terms as "fraud" and "misappropriation while acting in a fiduciary capacity": "The meaning of these words has been fixed by judicial construction for very nearly a century." *Id.* The Court further pointed out that, "'[t]hrough the intervening years that precept has been applied by this Court in varied situations with unbroken continuity." *Id.* (citing cases). *See also In re Rice & Reuben*, 43 F.2d 378, 380 (D. Me.1930)

(relying on the *Neal v. Clark* definition of fraud to distinguish a non-dischargeable debt arising from actual fraud from a dischargeable debt arising from constructive fraud). As this Court consistently reiterated, a debtor seeking a discharge places "the rectitude of his prior dealings squarely in issue" because the Bankruptcy Act limited the opportunity for a discharge to the "honest but unfortunate debtor." *Brown v. Felsen*, 442 U.S. 127, 128 (1979), *citing Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934).

In *Grogan v. Garner*, 498 U.S. 279, 290 (1991), the Court observed that by eliminating the requirement that the debt arising from fraud must be reduced to judgment in order to be dischargeable, a 1903 amendment to §17(a)(2) intentionally broadened the fraud exception to discharge. As the Court recognized, Congress thus returned to the historical antecedents of excepting from discharge all debts arising for the debtor's intentional wrongdoing (*id.*):

> As we explained in *Brown v. Felsen*, the 1898 Bankruptcy Act provided that "judgments" sounding in fraud were exempt from discharge. 30 Stat. 550. In the 1903 revisions, Congress substituted the term "liabilities" for "judgments." 32 Stat. 798. This alteration was intended to broaden the coverage of the fraud exceptions. *See Brown v. Felsen*, 442 U.S., at 138. Absent a clear indication from Congress of a change in policy, it would be inconsistent with this earlier expression of congressional intent to construe the exceptions to allow some debtors facing fraud judgments to have those judgments discharged.

In short, the relevant historical landscape is dominated by the "unbroken continuity" with which this Court has applied the *Neal v. Clark* standard. *Davis*, 293 U.S. at 331-32. That understanding — based on the distinction between intentional fraud and constructive fraud — provides the backdrop for an accurate interpretation of the 1978 Bankruptcy Code.

3. The Bankruptcy Code enacted in 1978 codified the *Neal v. Clark* distinction.

In enacting the Bankruptcy Code in 1978 (adding the term "actual fraud" to § 523(A)(2)(A)), Congress expressly recognized that wrongful intent, not misrepresentation, is the common thread

unifying the types of fraud for which discharge should be denied. The pivotal distinction between intentional and constructive fraud articulated in *Neal v. Clark* was carried forward in the Bankruptcy Code to except from discharge any debt arising from intentional fraud, even in the absence of a false representation from debtor to creditor. *See Archer v. Warner,* 538 U.S. 314, 316 (2003); *Cohen*, 523 U.S. at 217.

One of the few changes that the new Bankruptcy Code made to the predecessor section of § 523(a)(2)(A) was the insertion of the term "actual fraud" as a basis for denial of discharge. Congress made that change to codify this Court's long-standing precedents regarding wrongful intent and moral turpitude as "grounds for exception from discharge." H. Rpt. No. 95-595, at 364 (1978); *see also* S. Rpt. 95-989, at 77 (1978). *See* 1978 U.S.C.C.A.N. 5963, 6453 (95th Cong., 2d Sess.) (Statement of Hon. Don Edwards, Chairman of the Subcommittee on Civil and Constitutional Rights of the House Committee on the Judiciary) (inclusion of "actual fraud" in § 523(a)(2)(A) was for the purpose of "codify[ing] current case law e.g. *Neal v. Clark*, 95 U.S. 704 (1887), which interprets 'fraud' to mean actual or positive fraud rather than fraud implied in law").

This entrenched, well-understood view of the fraud exception to discharge continues to inform this Court's decisions. One instructive example from this Court's post-1978 jurisprudence: "The Bankruptcy Code has long prohibited debtors from discharging

liabilities incurred on account of their fraud, embodying a basic policy animating the Code...." *Cohen*, 523 U.S. at 217, *quoting Grogan v. Garner*, 498 U.S. at 287.

Examining the history and interpretation of the Bankruptcy Act of 1898, the Court explained (*Cohen*, 523 U.S. at 221):

> The history of the fraud exception reinforces our reading of § 523(a)(2)(A). The Bankruptcy Act of 1898 prohibited discharge of "judgments in actions for frauds, or obtaining property by false pretenses or false representations," § 17, 30 Stat. 550, and an award of punitive damages for fraud plainly fits in the category of "judgments in actions for fraud." The exception was broadened in 1903 to include all "liabilities for obtaining property by false pretenses or false representations," § 5, 32 Stat. 798, language that, *a fortiori*, encompasses liability for punitive damages. *See Brown*, 442 U.S., at 138 (interpreting the provision as prohibiting discharge of "all debts arising out of conduct specified" therein); *In re St. Laurent*, 991 F.2d, at 679 (noting "practice of holding debts for punitive damages nondischargeable" under this exception "if the compensatory damages ... were themselves nondischargeable"). And the

> Bankruptcy Act of 1978 enacted a "substantially similar" provision, *Brown*, supra, at 129, n. 1, barring discharge of "any debt ... for obtaining money, property, services, or ... credit, by ... false pretenses, a false representation, or actual fraud." 11 U.S.C. § 523(a)(2)(A) (1982 ed.).
>
> As the result of a slight amendment to the language in 1984, referred to in the legislative history only as a "stylistic change," *see* S. Rep. No. 98–65, at 80 (1983), § 523(a)(2)(A) now excepts from discharge "any debt ... for money, property, services, or ... credit, to the extent obtained by ... false pretenses, a false representation, or actual fraud." We, however, "will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure." [*Pa. DPW v.*] *Davenport*, 495 U.S. at 563....

To similar effect, *Archer v. Warner*, 538 U.S. at 316, held that language in § 523(a)(2)(A) denying discharge for fraud could "cover a debt embodied in a settlement agreement that settled a creditor's earlier claim 'for money . . . obtained by . . fraud.'" In so holding, the Court found that it must decide whether the same debt, now embodied in a settlement

agreement and promissory note, could also "amount to a debt for *money obtained by fraud*" within the terms of § 523(a)(2)(A). Relying on *Brown v. Felson* and *Cohen v. de la Cruz*, the Court explained in *Archer* that "'Congress intended the fullest possible inquiry' to ensure that 'all debts arising out of fraud are 'excepted from discharge,' no matter what their form." *Archer*, 538 U.S. at 316, *citing Brown*, 442 U.S. at 138. And *Archer* explicitly recognized that §523(a)(2)(A) applies to all debts that arise out of fraud. *Id.* at 321, *citing Cohen v. de la Cruz*, 523 U.S. at 215.

Even more recently, the Court's opinion in *Bullock v. BankChampaign, N.A.*, 133 S.Ct. 1754, 1759-60 (2013) again harkened back to the definition of "fraud" set forth in *Neal v. Clark*. In interpreting § 523(a)(2)(A) in the context of defalcation, the Court explained:

> We base our approach and our answer upon one of this Court's precedents. In 1878, this Court interpreted the related statutory term "fraud" in the portion of the Bankruptcy Code laying out exceptions to discharge. Justice Harlan wrote for the Court:
>
> "[D]ebts created by 'fraud' are associated directly with debts created by 'embezzlement.' Such association justifies, if it does not imperatively require, the conclusion that the 'fraud'

> referred to in that section means positive fraud, or fraud in fact, involving moral turpitude or intentional wrong, as does embezzlement; and not implied fraud, or fraud in law, which may exist without the imputation of bad faith or immorality." *Neal v. Clark*, 95 U.S. 704 (1878).

4. Contrary to the Fifth Circuit's view, the common law does not compel a narrow definition of "actual fraud."

In holding that "actual fraud" in §523(a)(2)(A) requires that the debtor made a false representation to the creditor, the Fifth Circuit misperceived the rationale and continuing vitality of *Neal v. Clark*. The Fifth Circuit also misapplied this Court's guidance in *Field v. Mans*, 526 U.S. 59 (1995), invoking the Restatement (Second) of Torts as its sole source for understanding the common law view of fraud that existed when the Bankruptcy Act was enacted in 1978.

The Fifth Circuit looked only to §§ 537 and 540 of the Restatement (Second). But those two sections do not constitute the universe of common law that existed in 1978; they do not even exhaust what the Restatement (Second) has to say on the subject. The topic of fraud without the prerequisite of misrepresentation is the subject of extensive commentary in Restatement (Second) of Torts § 871

(1977), concerning intentional harm to a property interest.[2] *See Sauer v. Lawson, Inc.*, 791 F.3d 214 (1st Cir. 2015) (quoting Restatement (Second) of Torts § 871). Comment e to § 871 explains:

> The actor's conduct is fraudulent if he intentionally causes another to act or refrain from acting by means of intentionally false or misleading conduct or by his intentional concealment of facts or by his intentional failure to disclose a fact that he has a duty to reveal to the other. The rule stated in this Section applies to one who assists another to commit a fraud.

Looking beyond the convenient summary that the Restatement provides to the actual reported decisions indicated that, "[t]he common law not only gives no definition to fraud, but perhaps wisely asserts as a principle that there is no definition of it...." *McAleer v. Horsley*, 35 Md. 439, 452 (1872). In fact, the concept of fraud is left "general and flexible" by design so that courts an "match their astuteness against the versatile inventions of fraud doers." *Stonemets v. Head*, 154 S.W. 108, 114 (Mo. 1913).

---

[2] Restatement (Second) Torts § 871 states: "One who intentionally deprives another of his legally protected property interest or causes injury to the interest is subject to liability to the other if his conduct is generally culpable and not justifiable under the circumstances."

The Fifth Circuit therefore was incorrect in its view that the common law regarded a false representation as a prerequisite to fraud in 1978. As the Seventh Circuit has concluded:

> No learned inquiry into the history of fraud is necessary to establish that it is not limited to misrepresentation and misleading omissions. "Fraud is a generic term, which embraces all the multifarious means which human ingenuity can devise and which are resorted to by one individual to gain an advantage over another by false suggestions or by suppression of truth. No definite and invariable rule can be laid down as a general proposition defining fraud, and it includes all surprise, trick, cunning, dissembling, and any unfair way by which another is cheated."

McClellan v. Cantrell, 217 F.3d 890, 893 (7th Cir. 2000), *quoting Stapleton v. Holt*, 207 Okla. 443, 250 P.2d 451, 453-54 (Okla. 1952).

The common law does not limit the concept of actual fraud to a single, narrow definition requiring a misrepresentation, but instead recognizes that courts possess a degree of flexibility in assessing claims of fraud. "As the leading treatise on bankruptcy explains, '[a]ctual fraud, by definition, consists of any deceit, artifice, trick or design

involving direct and active operation of the mind, used to circumvent and cheat another.'" *Sauer v. Lawson* (*In re Lawson*), 791 F.3d at 219, *quoting* 4 Collier on Bankruptcy ¶ 523.08[1] [e] (A.N. Resnick & H.J. Somer, eds., 16th ed. 2015).

A brief survey of judicial decisions interpreting the term "actual fraud" prior to and contemporaneous with enactment of the Bankruptcy Code disproves the notion that the common law applied a uniform, static definition of actual fraud that turned on a material misrepresentation. To be sure, many cases list material misrepresentation as an element of fraud; but others do not.

For example, in *Wallace v. Wallace,* 291 S.E.2d 386, 387-88 (W.Va. 1982), a case involving an alleged fraudulent transfer intended to reduce an alimony award, the Supreme Court of Appeals of West Virginia offered a detailed analysis of longstanding common law fraud principles:

> "Fraud" is a generic term, encompassing many different and ever-innovative forms: ... [W]hile it has often been said that fraud cannot or should not be precisely defined, the books contain many definitions, such as unfair dealing; malfeasance, a positive act resulting from a wilful intent to deceive; an artifice by which a person is deceived to his hurt; a wilful, malevolent act, directed to perpetrating a wrong to the rights of

others; anything which is calculated to deceive, whether it is a single act or a combination of circumstances, or acts or words which amount to a suppression of the truth, or mere silence; deceitful practices in depriving or endeavoring to deprive another of his known right by means of some artful device or plan contrary to the plain rules of common honesty; the unlawful appropriation of another's property by design; and making one state of things appear to a person with whom dealings are had to be the true state of things, while acting on the knowledge of a different state of things. Fraud has been said to consist of conduct that operates prejudicially on the rights of others and is so intended; a deceitful design to deprive another of some profit or advantage; or deception practiced to induce another to part with property or to surrender some legal right, which accomplishes the end desired. Fraud therefore, in its general sense, is deemed to comprise anything calculated to deceive, including all acts, omissions, and concealments involving a breach or legal or equitable duty, trust, or confidence justly reposed, resulting in damage to another, or by which an undue and unconscientious advantage is taken of another[.] (citations omitted).

In *Loucks v. McCormick,* 424 P.2d 555, 560 (Kan. 1967), the Supreme Court of Kansas outlined the established common law distinction "between actual and constructive fraud":

> Fraud, in the sense of a court of equity, properly includes all acts, omissions, and concealments which involve a breach of a legal or equitable duty, trust, or confidence justly reposed, and are injurious to another, or by which an undue and unconscientious advantage is taken of another. 1 Story, Eq.Jur., § 187.
>
> Constructive fraud consists in any act of omission or commission contrary to legal or equitable duty, trust or confidence justly reposed, which is contrary to good conscience, and operates to the injury of another. The former implies moral guilt; the latter may be consistent with innocence. [citation omitted].

Perhaps most important for present purposes is the fact that Congress specifically invoked this Court's *Neal v. Clark* model in enacting the Bankruptcy Code, thus focusing the availability of discharge on the presence of intentional misconduct rather than limiting the analysis to instances of false representation. And if further demonstration were needed that the *Neal v. Clark* formulation provides practical guidance that is consistent with the balance Congress sought to achieve, it can be found in the

recent experience of courts within the Seventh Circuit. Fifteen years ago, in *McClellan*, the Seventh Circuit applied the *Neal v. Clark* standard to the "actual fraud" category of § 523(a)(2)(A). *See* 217 F. 3d at 894. In the years since then, courts within that circuit have followed that holding without difficulty, and without the consequences about which the Fifth Circuit expressed concern in the decision below. *See, e.g., Forsythe v. Yeley*, 508 B.R. 82, 86 (S.D. Ind. 2014) (no fraud existed at the onset of the arrangement, but "actual fraud" existed when debtor took money from an account and used it for personal expenses); *Landmark Credit Union v. Reichartz* (*In re Reichartz*), 529 B.R. 696 (Bankr. E.D. Wisc. 2015) (describing the interplay among the three fraud exceptions in §523(a)(2)(A) subsequent to *McClellan); Eisenstein v. Eisenstein* (*In re Eisenstein*), 525 B.R. 428, 429 (Bankr. N.D. Ill. 2015) ("To establish a claim for actual fraud under § 523(a)(2)(A), a plaintiff must prove that (1) fraud occurred, (2) the debtor intended to defraud and (3) the fraud created the debt." *citing Wachovia Securities, LLC v. Jahelka* (*In re Jahelka*), 442 B.R. 663, 669 (Bankr. N.D. Ill. 2010); and *Metropolitan Real Estate Corp. v. Gard* (*In re Gard*), 327 B.R. 372, 375-376 (Bankr. N.D. Ind. 2003) (debtor made no misrepresentation to creditor but acted with "intent to defraud" when he closed on property purchase knowing that the tendered checks would not be honored).

To be sure, the Court has mentioned false representation from time to time in bankruptcy

cases; but only in cases that actually involved allegedly false representations, such as *Field v. Mans*. In dischargeability cases involving other forms of fraud, this Court made no mention of false representation as a required element. *See, e.g.*, *Archer*, 538 U.S. at 316; *Cohen*, 523 U.S. at 217.

5. Sound public policy supports the conclusion that § 523(A)(2)(A) does not limit "actual fraud" to false representations made by a debtor to a creditor.

A critical final point in understanding the relevant common law as it existed in 1978 (and continues to exist today): fraud was not then, and is not now, a static concept. As the forms of fraudulent conduct become more ingenious and sophisticated, as the technology for committing fraud becomes more complex and allows wrongdoers to deceive many people with a few barely detectable clicks, the Court should not abandon the established understanding that fraud comes in many forms. That newly-devised frauds may be more ingenious and sophisticated makes their victims all the more vulnerable. Common law and statutory notions of fraud have traditionally understood the vital importance of adapting to the ingenuity of intentional wrongdoers. In contrast, the decision below creates a safe harbor for fraud by erecting a buffer zone: so long as the wrongdoer makes no false representation to the victim, the § 523(a)(2)(A) exception from discharge does not apply. The standard articulated by the Fifth Circuit enables intentional wrongdoers to reap the

rewards of their dishonesty while further penalizing their victims. That standard strikes at the very integrity of the bankruptcy system. It should be rejected.

The Fifth Circuit's interpretation should also be rejected because it misperceives the relationship between §523(a)(2)(A) and other provisions in the Code. For example, the decision below refers to a potential redundancy between § 523(a)(2)(A) and § 523(a)(6) (as does the concurring opinion in the Seventh Circuit in *McClellan*). But § 523(a)(6) addresses different forms of conduct (*e.g.*, non-fraudulent malicious injury to property, such as arson). And § 523(a)(2)(A) is broader in subject matter (*e.g.*, it covers "any debt ... for money, ...services, or an extension, renewal, or refinancing of credit ..." in addition to "property"). Thus, some conduct may fit within (a)(2)(A) and not within (a)(6); the reverse is also true. And cases may arise that arguably fit into both sections. But the hypothetical possibility of some overlap is no reason to read "actual fraud" out of (a)(2)(A) altogether, or to construe that section in a way that conflicts with its plain meaning and legislative purpose. Indeed, under the Fifth Circuit's interpretation, the rest of (a)(2)(A) would also be vulnerable to the same analysis. The interpretation of § 523(a)(2)(A) that *amici* support conforms most faithfully to the

statutory language and to the balance the Bankruptcy Code is designed to achieve.[3]

Even if there were valid basis for concern about how § 523(a)(2)(A) "fits" with other provisions of the Code, the *Neal v. Clark* standard remains the optimal way to protect the balance Congress struck in the Bankruptcy Code. From the earliest days of

---

[3] Similar reasons should lead the Court to reject suggestions that petitioner's interpretation would create an asymmetry between the Code's provisions governing a fraudulent transferor and a fraudulent transferee. First, the discharge provisions exist within a larger context for combatting fraud. Thus, for example, fraudulent transferors are subject to criminal liability under 18 U.S.C. § 152. Moreover, any difference in the scope of discharge available to transferors versus transferees is not inherently unreasonable. The transferee, as recipient of the property, may thus be the best — or only — party in a position to make the victim whole. Additionally, deterrence against further transfers by the fraudulent transferee is a reasonable legislative policy choice.

Consider also that a party who intentionally fraudulently transfers property to a co-conspirator commits a general fraud as to all creditors equally. Had that transfer not been made, the transferred property would be liquidated in a Chapter 7 case and all creditors share pro rata in the proceeds of that liquidation. As to the transferee, however, participation in the fraudulent transfer harms only one creditor — the one who is also a creditor of the transferor. The transferee's other creditors actually benefitted from the fraudulent transfer — it provided a deeper pool of assets that could be liquidated to the benefit of all of the transferee's creditors equally. That is why § 727, 11 U.S.C. § 727, is not implicated as to the transferee. Rather, specific harms to specific creditors are dealt with under § 523—that subset of creditors who were individually harmed can seek the creditor-specific remedy of nondischargeability of a specific debt.

the bankruptcy system, and reiterated as recently as statutory amendments in 2005 (Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 314(b), 119 Stat. 23, 88 (2005)), Congress has endeavored to ensure that victims of deliberate fraud are made whole. Congress has, moreover, singled out fraud as particularly undeserving of the benefits of discharge. Where fraud is committed by a debtor may be the last person in a position to make the victim whole (because the debtor has received property obtained by fraud and any subsequent reconveyance of the property may make it impossible to recover), a narrow reading of "actual fraud" that rewards the debtor with a discharge would upset the equilibrium of rights and obligations on which the bankruptcy system depends.

For that reason, Congress opted for the *Neal v. Clark* standard as best suited to protect the victims of fraud while providing a fresh start to honest debtors. It is, accordingly, more consistent with the stated policy of the Code as a whole to adhere to the well-established *Neal v. Clark* formulation rather than follow the Fifth Circuit's course of narrowing the definition of "actual fraud" in a way that offers a roadmap for fraud. The *amicus* brief filed by the National Association of Bankruptcy Trustees explains how a potential wrongdoer could reenact the frauds in *McClellan, Lawson,* and this case — and get away with it — if the Fifth Circuit's interpretation of § 523(a)(2)(A) is upheld. Br. *Amicus Curiae* on Behalf

of the National Association of Bankruptcy Trustees in Support of Petitioner, No. 15-145, at 6-12.

But the Fifth Circuit's interpretation is even more worrisome. A potential wrongdoer could learn from some recent high-profile frauds and concoct a scheme that — by making the wrongdoer remote from his victims, thus avoiding misrepresentations to creditors — enables the wrongdoer to commit fraud and still get a fresh start under the Bankruptcy Code.

Consider how the Fifth Circuit standard would operate, for example, in a variation on the circumstances presented by "a $3.85 billion Ponzi scheme perpetrated by Minnesota businessman Thomas J. Petters." *Ritchie Capital Management, L.L.C. v. Jeffries*, 653 F.3d 755, 757 (8th Cir. 2011). That scheme involved multiple entities (including a venture capital firm that employed numerous single-purpose entities) and multiple people (including executives of various Petters-related companies). *Id.* at 758. But the fraudulent scheme was also facilitated by feeder funds, which were independent entities that raised money from their own investors and passed funds along to a Petters entity. Thus, various barriers and buffers existed between the principal perpetrator of the fraud and the defrauded investors. *See Peterson v. Somers Dublin Ltd.*, 729 F.3d 741, 744 (7th Cir. 2013); *United States v. Reynolds*, 643 F.3d 1130, 1132 (8th Cir. 2011). Through these means, Mr. Petters avoided direct solicitation to investors and did not make false representations to the investors who dealt only with

their own hedge funds. *See United States v. Fry*, 792 F.3d 884, 886 (8th Cir. 2015).

The Madoff-related fraud offers yet another example of a Ponzi scheme implemented through multiple layers of entities from which an intentional wrongdoer could develop a scheme that separated the principal from large numbers of victims. Many of the more than 15,000 investors who filed fraud claims totaling billions of dollars had no direct contact with Mr. Madoff, but invested in feeder funds that passed money through to Madoff entities. *See Picard v. JPMorgan Chase & Co.* (*In re Bernard L. Madoff Securities LLC*), 721 F.3d 54, 60 (2d Cir. 2013); *see also In re Bernard L. Madoff Inv. Securities LLC*, 654 F.3d 229, 231 (2d Cir. 2011); *In re Bernard L. Madoff Inv. Securities LLC*, 424 B.R. 122, 127 (S.D.N.Y. 2010). Had Mr. Madoff sought the protection of the Bankruptcy Code, the line drawn by the Fifth Circuit in this case poses the distinct risk that debts owed to only the small subset of the 15,000 defrauded investors to whom Mr. Madoff himself made false representations would be excepted from discharge.

These contemporary fraud schemes exemplify why this Court's traditional formulation should remain in place. The Fifth Circuit's departure from the *Neal v. Clark* standard disturbs the balance of the Bankruptcy Code in ways that would have adverse economic consequences.

CONCLUSION

The judgment of the Fifth Circuit should be reversed and the case remanded for further proceedings.

Respectfully submitted.

JOHN J. MONAGHAN
KATHLEEN ST. JOHN
HOLLAND & KNIGHT LLP
10 Saint James Ave.
Boston, MA 02116

JERROLD J. GANZFRIED
Counsel of Record
HOLLAND & KNIGHT LLP
800 17th Street, N.W.
Washington, D.C. 20006
(202) 469-5151
jerry.ganzfried@hklaw.com

ROBERT J. LABATE
RICHARD A. BIXTER, JR.
HOLLAND & KNIGHT LLP
131 South Dearborn St.
Chicago, IL 60603

BARBRA PARLIN
HOLLAND & KNIGHT LLP
31 West 52nd Street
New York, NY 10019

Counsel for Amici Curiae

DECEMBER 28, 2015